



**NASAA**

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**NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION, INC.**

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February 13, 2004

Jonathan G. Katz, Secretary  
Securities and Exchange Commission  
450 Fifth Street, N.W.  
Washington, D.C. 20549-0609

Via E-Mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov)

Re: **File No. SR-NASD-2004-05, Release No. 34-49081**  
**Proposed Amendment to NASD Rule 2370, Agents Borrowing or Lending**  
**Money from Customers.**

Dear Mr. Katz:

The North American Securities Administrators Association, Inc. (“NASAA”)<sup>1</sup> submits this comment on the NASD proposal to amend NASD Rule 2370. NASAA previously commented by letter of July 23, 2003 regarding the creation of Rule 2370.

As NASAA articulated in its July 23, 2003 comment letter, even a transaction that meets one of the five exceptions in Rule 2370 may be considered a dishonest or unethical practice under state laws. *See* the “Dishonest and Unethical Business Practices of Broker-Dealers and Agents” as set forth in CCH NASAA Reports ¶1403(2)(a), which has been adopted by most states. The proposed NASD rule could erode national regulatory standards and widen the differences between state and NASD rules.

The proposed rule would remove the requirement that lending or borrowing arrangements with customers be pre-approved in writing if the customer is either (a) an immediate family member or (b) a financial institution regularly engaged in the business of providing credit, financing, or loans, or other entity or person that regularly arranges or extends credit in the ordinary course of business. The rule further provides that under these circumstances, agents are not even required to notify the firms that they are engaging in lending or borrowing arrangements with such customers.

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<sup>1</sup> The oldest international organization devoted to investor protection, the North American Securities Administrators, Inc. was organized in 1919. Its membership consists of the securities administrators in the 50 states, the District of Columbia, Canada, Mexico and Puerto Rico. NASAA is the voice of securities agencies responsible for grass-roots investor protection and efficient capital formation.

A conflict is created whenever an agent enters into lending or borrowing arrangements with a customer, regardless of the relationship with the customer. Firms have a duty to protect all customers. This includes customers who are family members. Customers rightly expect that a firm stands behind all of its agents and is adequately supervising all agents' activities. Regulators also expect proper oversight and supervision over all agents and all customer accounts. To properly execute their supervisory duties, it is extremely important that firms be aware of all outside business activities and personal financial problems of their agents.

NASAA is concerned with the provisions of this NASD rule that relate to immediate family members and those with whom an agent has a personal or business relationship, as listed in the exceptions to the rule. Despite the assumption that there is less potential for problems between an agent and immediate family members, acquaintances or business colleagues, our experience indicates otherwise. State regulators have encountered numerous instances where an immediate family member or business acquaintance has become the victim of improper – even fraudulent – actions by an agent. In addition to reducing protections for these customers, the proposed rule could send the wrong message to firms that they are not responsible for any wrongdoing involving the account of an immediate family member. Firms may actually attempt to use the proposed rule to deny responsibility under these circumstances.

This rule permits firms to turn a blind eye on activity that may be a warning sign of serious problems with an agent. The fact that an agent borrows large sums of money from family members may be indicative of serious problems that will ultimately involve other customers – i.e., are the loans to pay for escalating debts?

Of further concern are the exceptions for lending arrangements based on personal or business relationships outside of the broker-customer relationship. These exceptions may encompass large numbers of customers. What constitutes “personal” and “business” relationship is open to interpretation, and this interpretation is initially left to the broker's discretion.

Thank you for the consideration of these views. If you have further questions, please do not hesitate to contact Tanya Solov, Chair of NASAA's Broker-Dealer Section and Director of the Illinois Department of Securities, or George Robison, Director of Licensing & Compliance, Utah Division of Securities.

Sincerely,

*Ralph A. Lambiase*

Ralph A. Lambiase  
NASAA President and  
Director, Connecticut Division of Securities